

INTERNATIONAL STANDARD ON ASSURANCE ENGAGEMENTS (ISAE) 3402, ASSURANCE REPORTS ON CONTROLS AT A SERVICE ORGANIZATION

This overview has been prepared by staff of the International Auditing and Assurance Standards Board (IAASB). It relates to, but does not form part of, International Standard on Assurance Engagements (ISAE) 3402, *Assurance Reports on Controls at a Service Organization*, the text of which alone is authoritative. Reading this overview is not a substitute for reading the ISAE, and reference to the ISAE itself should always be made.

ISSUED

December 2009

EFFECTIVE FOR

Service auditors' assurance reports covering periods ending on or after June 15, 2011.

BACKGROUND

Increasingly, entities outsource aspects of their businesses to organizations that provide services ranging from performing a specific task under the direction of the entity to performing one or more of the entity's business functions. Frequently, such services relate to information used by the service organization's clients to prepare their financial statements. Where this is the case, the service organization often provides its clients with a description of the relevant controls at the service organization and assertions about the effective design of those controls and their operating effectiveness. In fulfilling their responsibilities under International Standards on Auditing (ISAs), auditors of those clients ordinarily seek an assurance report prepared by the service organization's auditor to support the service organization's description and assertions.

SCOPE

ISAE 3402 deals with assurance engagements by professional accountants in public practice to provide a report for use by user entities and their auditors on the controls at a service organization that provides a service to user entities that is likely to be relevant to user entities' internal control, as it relates to financial reporting.

ISAE 3402 applies to engagements that convey reasonable assurance when the service organization is responsible for the suitable design of controls. It does not deal with assurance engagements:

- (a) To report on whether controls at a service organization operated as described, or
- (b) To report only on controls at a service organization that are not related to a service that is likely to be relevant to user entities' internal control as it relates to financial reporting (for example, controls that affect user entities' production or quality control).

SUMMARY

ISAE 3402 complements ISA 402,¹ in that ISAE 3402 reports are capable of providing appropriate evidence under ISA 402.

ISAE 3402 focuses on two types of assurance reports, known as type 1 and type 2 reports. In a type 1 report, the service auditor opines on: (a) whether a service organization's description of controls fairly presents the system as designed and implemented, and (b) whether the controls related to the control objectives stated in the description were suitably designed. In a type 2 report, the service auditor also opines on whether those controls operated effectively throughout a specified period.

¹ ISA 402, *Audit Considerations Relating to an Entity Using a Service Organization*.

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Key provisions of the ISAE include those relating to:

- Engagement acceptance and continuance conditions, including that the service organization acknowledges and understands its responsibility to have a reasonable basis for its assertions about the fair presentation of its description, the effective design of controls and, for a type 2 report, the operating effectiveness of controls.
- Assessing the suitability of the criteria used by the service organization in making its assertions.
- The nature, timing and extent of evidence gathering procedures with respect to each component of the assurance report.
- The elements of the service auditor's report.

Appendices to the ISAE include examples of service organization's assertions and of service auditor's assurance reports.

IMPLICATIONS FOR PRACTICE

ISAE 3402 is a new standard, therefore how it affects practice in any particular jurisdiction will depend on what standards and practices are currently in place in that jurisdiction. Some features of the standard that are likely to affect practice include:

- By founding the engagement on an assertion-based model, ISAE 3402 clearly distinguishes the service organization's responsibilities with respect to controls from the service auditor's responsibility to form an opinion, thereby reinforcing the service auditor's independence.
- The ISAE articulates the minimum elements of criteria for evaluating whether a service organization's description of its system is fairly presented and whether controls are designed and operating effectively. This will enhance consistency in the work of service auditors in different jurisdictions.
- ISAE 3402 adopts a risk-based approach, which requires service auditors to focus on the risks that threaten the achievement of stated control objectives and to evaluate the linkage between the service organization's controls and those risks.
- ISAE 3402 will improve the transparency of service auditors' reports by requiring the work of internal auditors to be separately identified in that part of the assurance report describing tests of controls performed by the service auditor.
- The standard clarifies that service auditors have a responsibility to take appropriate action if they become aware of non-compliance with laws and regulations, fraud, or uncorrected errors attributable to a service organization that are not clearly trivial and may affect one or more user entities.

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